

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 IO-13 PA-01 PRS-01 L-03 H-01
NEA-10 AID-05 CIAE-00 COME-00 EB-07 FRB-03 INR-07
NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02 LAB-04
EPG-02 SIL-01 OMB-01 NSC-05 SS-15 STR-04 CEA-01
/105 W

-----001303 110404Z /16

P 110240Z JUL 77

FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 2147

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USADB

FOR NAC AGENCIES

PASS TREASURY FOR BRADFORD

E.O. 11652: ADS, DECLAS 12/31/77

TAGS: EAID, EFIN

SUBJECT: REVIEW OF ADB LENDING RATE

REF: (A) STATE 156569, (B) MANILA 10535

SUMMARY: ADB MANAGEMENT HAS RECOMMENDED THAT LENDING RATE OF BANK FOR LOANS FROM ORDINARY CAPITAL RESOURCES APPROVED ON OR AFTER JULY 1, 1977 AND UP TO DECEMBER 31, 1977 BE FIXED AT 8.25 PERCENT PER ANNUM, A REDUCTION OF 45 BASIS POINTS BELOW EXISTING RATE OF 8.70. NAC GUIDANCE IS REQUESTED. END SUMMARY.

1. ADB DOC. R68-77 ON ABOVE SUBJECT BEING POUCHED JULY 11 AND WILL BE CONSIDERED BY BOARD OF DIRECTORS JULY 28.

2. DOCUMENT BEGINS BY LISTING FOLLOWING RECOMMENDATIONS
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RELATING TO BANK'S FINANCIAL POLICIES, WHICH WERE APPROVED BY BOARD OF DIRECTORS IN MARCH 1977:

A. LENDING RATE SHOULD BE SET AT BEGINNING OF EACH YEAR FOR ENTIRE YEAR UNLESS IMPORTANT DEVELOPMENTS, SUCH AS SUBSTANTIAL CHANGE IN BANK'S BORROWING COSTS FROM THOSE ANTICIPATED OR SIGNIFICANT CHANGE IN LENDING RATE OF IBRD, CALLED

FOR REVIEW IN INTERVENING PERIOD;

B. NORMALIZED AVERAGE BORROWING COST OF BANK DURING PREVIOUS TWELVE MONTHS SHOULD BE BASIS FOR DETERMINING LENDING RATE;

C. LENDING RATE SHOULD BE DERIVED BY ADDING A POSITIVE SPREAD (DERIVED FROM ADMINISTRATIVE EXPENSES FOR ORDINARY OPERATIONS AND PROPORTION OF FUNDED DEBT IN LAON COMMITMENT WHICH REFLECTS IMPACT OF ADMINISTRATIVE EXPENSES IN CIRCUMSTANCES OF CURRENT FINANCIAL STRUCTURE OF BANK) TO COST MENTIONED IN (B) ABOVE TO REFLECT IMPACT OF ADMINISTRATIVE EXPENSES;

D. INTEREST COVERAGE RATIO AND RESERVE: LOAN RATIO SHOULD BE MAINTAINED AT NOT LESS THAN 1.25 AND 15 PERCENT, RESPECTIVELY; AND

E. FINANCIAL POLICIES OF BANK, INCLUDING LENDING RATE AND COMMITMENT CHARGE, SHOULD BE REVIEWED ANNUALLY AT BEGINNING OF EACH YEAR.

3. WHEN IBRD REDUCED ITS LENDING RATE FROM 8.50 PERCENT TO 8.20 PERCENT IN APRIL 1977, ADB PRESIDENT TOLD BOARD HE DID NOT PROPOSE CHANGE IN BANK'S LENDING RATE OF 8.70 PERCENT BECAUSE, INTER ALIA, SINCE MARCH 1977 NO NEW FACTORS HAD EMERGED TO CHANGE BANK'S FINANCIAL SITUATION AND PROSPECTS, AND LENDING RATE HAD BEEN REVIEWED AND FIXED BY BOARD ONLY LIMITED OFFICIAL USE

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A MONTH EARLIER. PRESIDENT, HOWEVER, AHD STATED THAT LENDING RATE MIGHT BE REVIEWED IN DUE COURSE TAKING INTO ACCOUNT DEVELOPMENTS THAT MIGHT TAKE PLACE IN SECOND QUARTER OF YEAR. SINCE THEN, IBRD HAS REDUCED FURTHER ITS LENDING RATE WITH EFFECT FROM JULY 1 TO 8.00 (AND IT IS UNDERSTOOD IDB HAS REDUCED ITS RATE FROM 8.35 TO 8.00 AS OF SAME DATE).

4. DOCUMENT STATES THAT IN PRESENT REVIEW OF BANK'S LENDING RATE AND IN TERMS OF BOARD'S DECISION OF MARCH 1977, TWO FACTORS CALL FOR CONSIDERATION. ONE IS REDUCTION IN IBRD'S LENDING RATE FROM 8.50 TO 8.20 AND THEN TO 8.00 PERCENT PER ANNUM, AND OTHEER IS BANK'S BORROWING EXPERIENCE SO FAR THIS YEAR. APART FROM ROLL-OVER OF \$70 MILLION TWO-YEAR BONDS, THERE HAS SO FAR BEEN ONLY ONE BORROWING IN 1977, IN DEUTSCHE MARK OF \$42 MILLION EQUIVALENT, AT COST TO BANK OF 7.33 PERCENT AND WITH AVERAGE LIFE OF EIGHT YEARS. NORMALIZED AVERAGE BORROWING COSTS FOR PRECEDING TWELVE MONTHS (I.E., FOR CALENDER YEAR 1976) WAS 8.43 PERCENT AT TIME LENDING RATE WAS FIXED AT 8.70 PERCENT PER ANNUM. AS OF JULY 1, 1977, CORRESPONDING COST FOR PRECEDING TWELVE MONTHS (I.E., JULY 1, 1976 TO JUNE 30, 1977) WORKS OUT TO 7.986 PERCENT PER ANNUM. FURTHER BORROWINGS IN 1977 HAVING DESIRED EFFECT OF

ELONGATING MATURITY OF BANK'S FUNDED DEBT AND AT ATTRACTIVE

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 SP-02 USIA-06 AID-05 EB-07
NSC-05 EPG-02 SS-15 STR-04 OMB-01 CEA-01 CIAE-00
COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PA-01 PRS-01 IO-13 NEA-10
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COSTS, ARE NOT CURRENTLY IN SIGHT, ALTHOUGH UNDER MARCH 1977
FINANCIAL POLICY DECISIONS, 1977 BORROWINGS COULD POSSIBLY
GO UP TO \$260 MILLION, INCLUDING TWO-YEAR BONDS.

5. ANOTHER FACTOR IN DETERMINATION OF LENDING RATE IS
POSITIVE SPREAD (BASED ON PROPORTION OF FUNDED DEBT IN
LOAN COMMITMENT AVERAGED OVER TWO-YEAR PERIOD BEGINNING
JANUARY 1, 1976) TO REFLECT BANK'S ADMINISTRATIVE EXPENSES.
THIS SPREAD, TO BE ADDED TO BORROWING COST, HAD BEEN COMPUTED
AS 0.28 IN JANUARY 1977. AT THIS POINT, DOCUMENT INDICATES
THERE ARE NO INDICATIONS OF A SIGNIFICANT CHANGE IN
ADMINISTRATIVE EXPENSES AND OTHER RELEVANT FACTORS, NAMELY,
FUNDED DEBT AND LOAN COMMITMENTS, FROM THOSE ASSUMED IN
JANUARY 1977, WHICH MIGHT NOW WARRANT REVISION IN SPREAD.
BASED, THEREFORE, ON SPREAD OF 0.28 NEW LENDING RATE WORKS
OUT TO 8.27 PERCENT PER ANNUM, WHICH ROUNDED TO NEAREST
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FIVE BASIS POINTS IS 8.25 PERCENT PER ANNUM.

6. DOCUMENT ALSO PROPOSED THAT LENDING RATE TO BE DECIDED SHOULD BE MAINTAINED FOR REST OF 1977 BECAUSE OF UNSETTLING EFFECT THAT EXPECTATION OF FURTHER CHANGE IN LENDING RATE IN COURSE OF 1977 MAY HAVE ON NEGOTIATION AND DECISION OF LOANS IN REMAINING MONTHS OF FISCAL YEAR WHEN GREATER NUMBER OF LOAN DECISIONS ARE EXPECTED TO BE MADE.

7. IMPACT OF REDUCTION IN LENDING RATE OF 8.25 PERCENT PER ANNUM ON FINANCIAL SITUATION OF BANK HAS BEEN ROUGHLY ESTIMATED TAKING INTO ACCOUNT (A) ADVANCE PAYMENTS BY CANADA OF THIRD AND FOURTH INSTALLMENTS OF ITS SPECIAL CAPITAL INCREASE (TOTALLING ABOUT \$25.01 MILLION, OF WHICH \$11.57 MILLION IS ARTICLE 6.2(A) PORTION) WHICH WERE DUE IN 1978 AND 1979 BUT WERE MADE IN 1977, AND (B) SHORFALL IN PROJECTED DISBURSEMENTS IN 1977 OF ABOUT 10 PERCENT, WHICH IS ASSUMED TO BE MADE UP IN SUBSEQUENT YEARS.

8. DOCUMENT INDICATES THAT, WITH PROPOSED LENDING RATE, RESERVE: LOAN RATION REMAINS WELL ABOVE MINIMUM OF 0.15 PERCENT UNTIL 1981 AND BEYOND. BUT AFTER 1981 INTEREST COVERAGE RATIO FALLS BELOW 1.25 AND NET INCOME ALSO STARTS SHOWING SLIGHT DOWNWARD TREND. REVIEW OF BANK'S FINANCIAL POLICIES IN BEGINNING OF 1978, BESIDES TAKING INTO ACCOUNT EFFECT OF LENDING RATE NOW DECIDED BY BOARD, WILL HAVE TO EXAMINE MEASURES TO ENSURE THAT FINANCIAL SITUATION AFTER 1981 ALSO REMAINS SATISFACTORY.

9. IN LIGHT OF FOREGOING, MANAGEMENT RECOMMENDS THAT LENDING RATE FOR ORDINARY CAPITAL LOANS APPROVED ON OR AFTER JULY 1, 1977 AND UP TO DECEMBER 31, 1977 BE FIXED AT 8.25 PERCENT PER ANNUM. NAC GUIDANCE IS REQUESTED.
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Message Attributes

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